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**WORKOUTS AND RESTRUCTURINGS
IN MALAYSIA**

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WORKOUTS AND RESTRUCTURINGS IN MALAYSIA

Good afternoon, distinguished guests, ladies and gentlemen. First of all, I would like to thank the Organisation for Economic Cooperation and Development, the World Bank, Asia Pacific Economic Cooperation and the Australian Treasury for giving me this opportunity to share with you some perspectives of what Malaysia is doing in the field of workouts and restructurings.

PREAMBLE – PRE-CRISIS PERIOD

Let me begin by examining the pre-crisis period. During the pre-crisis period, economic expansion was largely funded by debt, obtained significantly from the banking sector. Due to the absence of a mature bond market, large funding requirements for privatisation projects and large-scale infrastructure projects could not be adequately met by the domestic capital market. Consequently, funding mismatches occurred when long-term financing requirements were met by short-term bank borrowings. The brunt of the economic turmoil was, therefore, absorbed by the banking system.

Besides the financing related problem, other fundamental issues were inadequately addressed. Companies were more concerned with earnings per share (EPS) instead of cash flow adequacy. Indiscriminate costly borrowings led to highly geared position and low interest coverage. Conditions of companies with US Dollars borrowings were worst off when the Ringgit started to depreciate against the US Dollars at the height of the crisis.

The severity of the economic downturn, the sharp currency depreciation and stockmarket upheaval experienced in 1997 and 1998 had adversely affected a large number of corporations. The spate of Section 176 applications seeking court protection in the first half of last year as well as actions by financial institutions to initiate insolvency proceedings have unveiled several shortcomings in the current insolvency legislation. Specifically, it does not provide the range of solutions required to preserve value for affected stakeholders, especially in a complex multi-lender situation. For the most part, the usual receivership and liquidation administrations do not discriminate viable businesses from the non-viable, resulting in the inevitable demise (in most cases), of affected companies.

The source of distress for many companies is largely related to financing, which when resolved, will significantly improve their prospects and viability. Hence, a more balanced

approach to address corporate financial distress is needed in terms of orderly workouts of debtor-creditor problems.

NEW AGENCIES FOR RESTRUCTURING

To mitigate the adverse impact of the Asian financial crisis and the ensuing economic downturn in Malaysia, the Government initiated a new infrastructure in mid-1998 to speed up financial restructuring of both the banking and corporate sectors. This infrastructure comprises 3 agencies, namely, Danaharta (which is an asset management company), Danamodal (a bank recapitalisation agency) and the Corporate Debt Restructuring Committee.

Pengurusan Danaharta Nasional Berhad (“Danaharta”)

Danaharta was established by way of legislation in June 1998 as an asset management company to remove non-performing loans ("NPL") with size of above RM5 million from the banking sector. This action intends to free up management and capital resources of the banking sector, whereby banks can then concentrate on their role as a lending agency to stimulate economic recovery. The longer funding structure of Danaharta compared to banks would give Danaharta greater flexibility in maximising the recovery of the NPLs.

Danamodal Nasional Berhad (“Danamodal”)

Danamodal, a special purpose company, was set up in August 1998 to recapitalise and strengthen banking institutions to promote stability. The role of Danamodal is important in so far as to ensure that the banking sector continues to play its role of being a lending conduit to corporations and individuals. Banks that have been weakened or become under-capitalised due to the burden of NPLs were recapitalised by this agency so that prudential banking regulations are not breached. Recapitalised banking institutions would then be in a better position to focus on providing funding to companies that contribute to Malaysia's economic recovery.

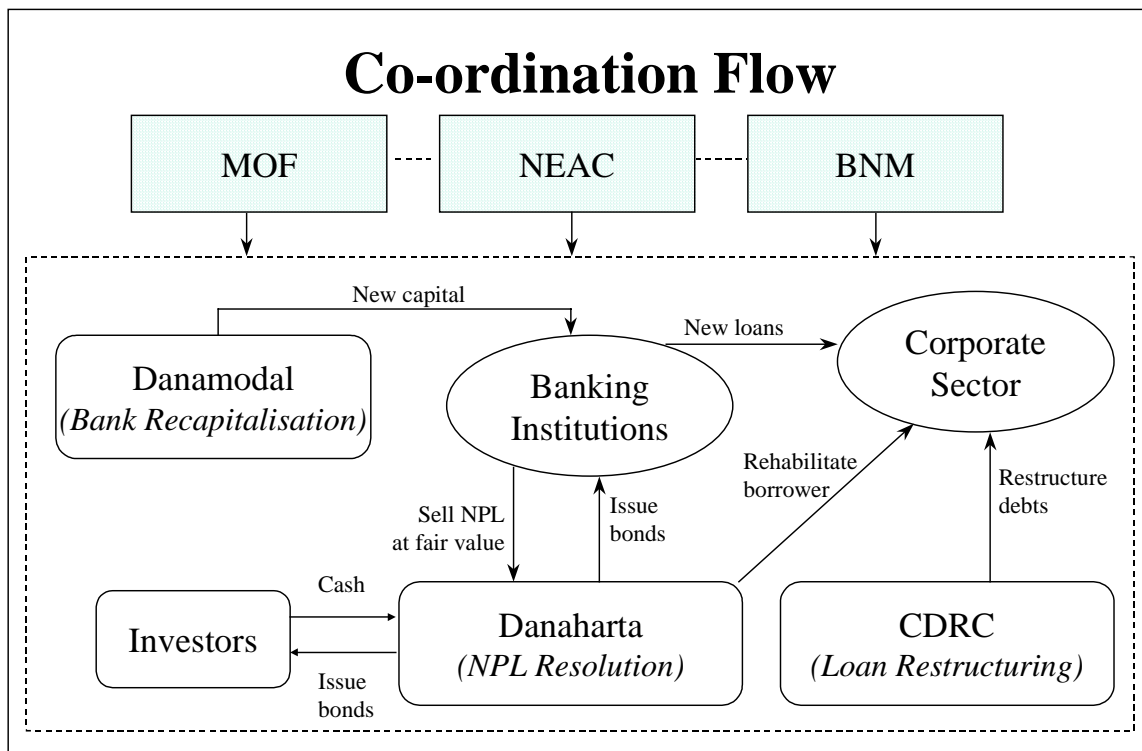
Corporate Debt Restructuring Committee (“CDRC”)

The set-up of the CDRC follows the “London Approach” model. The CDRC is essentially a steering committee where debts are restructured on an informal basis between the distressed companies and their creditors. The CDRC's role is to help restructure large corporate debts in excess of RM50 million. All applications to the CDRC are made on a voluntary basis. The CDRC does not have any legal powers of its own as in the case of Danaharta which obtain its powers from legislation. However, as

part of the central bank, the CDRC inherits the central bank's moral suasion powers in its dealings with financial institutions. In solving the companies' problems, the CDRC also plays a more important role in ensuring NPLs in the banking sector are minimised through restructured debt arrangements.

In the course of finding solutions for distressed corporations, the CDRC is also undertaking wider scale industry studies to evaluate possible industry solution rather than a company solution in cases involving strategic industries like telecommunication, steel and transportation sectors. Besides the strengthening of the banking system, the restoration of corporate health is deemed to be an equally important task in steering the economy back to its long-term sustainable growth path.

It is important to recognise that Danaharta, Danamodal and CDRC are interdependent and complementary in the aim to restructure and strengthen the financial sector. In this respect, a Steering Committee chaired by the Governor of Bank Negara Malaysia oversees the coordination, policies and progress of all three agencies.



Note: (1) MOF - Ministry of Finance Malaysia
 (2) NEAC - National Economic Action Council
 (3) BNM - Bank Negara Malaysia (Central Bank of Malaysia)

INTERPLAY OF FORMAL AND INFORMAL WORKOUTS

In Malaysia, the CDRC is but just one of many parties involved in debt restructuring. Due to the purpose of its existence in helping to restructure large corporate debts during the economic crisis, it was sometimes misperceived that the CDRC is the only restructuring agency.

Let me explain the situation in Malaysia. We are fortunate to have inherited the common law system from the British and have developed our companies laws based on the British and Australian model in the 1960s. The existence of a comprehensive insolvency and liquidation law allows creditors of Malaysian companies to be adequately protected at all times. This put Malaysia in a better position when compared against some other countries affected by the Asian economic crisis.

The most important section in the Companies Act 1965 with respect to corporate restructuring is section 176. This section allows a restructuring to proceed under the court's supervision where the decisions of the majority¹ creditors are binding on the minority creditors. The beauty of this provision is that it gives some assurances against the destruction of viable businesses by unreasonable creditors. To prevent abuses of this section, companies can only obtain the court protection if it is supported by their creditors. This provision of the Companies Act was relied upon extensively by companies in the early days of the crisis to undertake a court sanctioned corporate restructuring. In cases where restructuring is not the desired objective, creditors can choose to wind up distressed companies under Part 10 on the same Act.

As opposed to section 176 restructuring, the CDRC's framework is an informal process where creditors and borrowers meet under the mediation of the CDRC. It is the norm for companies and creditors to agree on a three-month standstill period for a scheme to be proposed by an independent consultant. The proposed scheme will be subject to scrutiny by the company, creditors and the CDRC where each party will give its input for enhancement of the scheme. Finally, the restructuring itself will be formalised by way of a restructuring agreement detailing the covenants and conditions sought by creditors to restructure outstanding debts. Although the CDRC's framework only requires majority support for the scheme, in practice, we try our best to appease everybody so that any scheme will have unanimous support of creditors. As CDRC deals mainly with bank

¹ Defined as at least 75% in value and 50% in number of creditors.
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creditors, some of the restructuring will be moved for completion under section 176 should there be a need to manage numerous other kind of creditors.

ISSUES AND CHALLENGES

Let me now turn to the issues faced and lessons learned. I shall touch on the widely cited concerns about, firstly, the pace and depth of corporate restructuring in Malaysia, secondly, the transparency and moral hazard problems, and thirdly, cancellation of credit facilities for distressed companies.

Pace and Depth of Corporate Restructuring

It is generally difficult to find consensus on how fast or extensive financial and corporate restructuring should be. In fact, there are both domestic and foreign critics who criticized the CDRC for being slow – failing to understand that CDRC is purely a mediator with no powers to compel either the creditor or debtor to proceed in a certain manner. All decisions are by mutual discussion and the final decision has to be unanimously accepted after detailed and independent appraisals. Amicable solutions are often unique as the nature of debtor and creditor problems varies from case to case.

Thus, to maximise the utilisation of CDRC's resources, only distressed companies which have at least RM50 million debt, which are not under liquidation and which involve multi-lender institutions, are eligible for workout assistance. The largest case that was resolved by CDRC involved RM5.4 billion debts owed to 81 financial lenders. The average size of cases under the CDRC based on our latest statistics is RM698 million.

Proponents of "creative destruction" would argue for speedy closure of distressed companies so weak, inefficient companies are weeded out and problems of excess supply resolved quickly through liquidation. However, at the industry and company level, these issues are not so clear cut. The financial crisis that hit Malaysia in 1997 was an unanticipated, episodic event, which suggests that they occur during normal economic conditions. The current recovery in Malaysia's export and domestic demand is a case in point which argues that other innovative mechanisms to resolve corporate distress should be explored so that the corporate sector, labour market and social fabric do not suffer unnecessary dislocation and disruptions.

The critics should also be aware that the process of liquidation by itself is not fast track given the extensive procedures that have to be complied with before liquidation becomes eventuality. A voluntary workout under CDRC could achieve a better result without the additional cost, at a faster pace, and without the disruption to the labour market and social fabric.

Our experience shows that there is a need to strike a balance between ensuring speedy resolution and subjecting each case to systemic scrutiny, beginning with an assessment report by independent consultants acting on behalf of the creditors and CDRC. Thus we believe that there should not be undue emphasis on the pace of the debt workouts. Rather the focus should be on the socio-economic value-added and the spillover effects on investor confidence and financial system stability. Thus, CDRC's role is important not just as a means of resolving the financial distress of key companies but also to reduce risks arising from dislocations in financial and product markets, employment, investors sentiments, etc.

Bailouts, Moral Hazard and Transparency Issues

Let me now address the issue of transparency, moral hazard and bailout. One of the main concerns expressed by many quarters in Malaysia and overseas is whether the path of corporate restructuring in Malaysia leads to moral hazard later on. Should we be penalising shareholders and managers of distressed companies so that they do not repeat similar mistakes? Are we propping up weak, inefficient companies and throwing good money after bad ones?

From cases we have dealt with, I believe that these issues are not a problem for the CDRC since the burden of adjustment and restructuring risks are shared among creditors and debtors. The underlying principle adopted by CDRC is that the debt resolution process and decisions should be private sector and market-driven so that issues of economic viability, company restructuring, valuation and burden sharing are debated and agreed upon by all the parties involved. As such, the decision taken on the nature of the debt workout and corporate restructuring would involve all the key players and as many as six parties, namely the independent consultant, creditors, company's management, shareholders, regulators and CDRC. We believe the inputs from and review by all these parties will help to ensure that corporate restructuring is completed under terms that meet the competing interests of all the concerned parties. The final restructuring plan is also publicly disclosed to provide full transparency on how a company has been restructured.

Freezing of Credit Lines

The common problem faced in most situations is the cancellation and freezing of credit lines to distressed companies by financial institutions and the bankers' reluctance to provide new funding even to viable businesses. In resolving these issues, the CDRC is faced with several challenges. The first challenge is to enlist creditors' support for the restructuring scheme that is formulated after an in-depth study of the company's financial profile and cash flow prospects. The second challenge is to secure additional funding for debtor companies to complete projects which are deemed to be viable after an assessment by an independent consultant appointed by the lenders. The third challenge is to ensure that creditors and debtors meet the deadline set after the restructuring proposals have been formulated.

THE WAY FORWARD

Despite the challenges faced, the CDRC will continue to press on with its task to facilitate debt restructuring. We have completed restructuring RM12.7 billion of debts but our job is not finished. We shall be able to complete another RM7 billion over the next two months and hopefully the balance RM9.6 billion before June 2000.

Our job has been made easier by the relative stability in our domestic financial markets and low interest rate policy. Asset prices particularly quoted shares and properties have undergone downward adjustment but they have not become an insurmountable problem. With the upturn in economic activities and stock market value, the expected improvement in corporate balance sheet will help in the restructuring process which often require divestment of non-core assets. Although the economic improvement may not necessarily speed up the debt restructuring process, I believe both debtors and creditors can obtain a better solution than otherwise possible.

In looking at the way forward, the Government has taken steps to further develop the domestic bond market in efforts to better diversify the risks from the banking sector to other investors. Previously, in the absence of a mature bond market, economic expansion was funded almost entirely by the banking sector. Once these steps are fully implemented, the risk would be diversified away from the banking sector.

The Government has also been most supportive in providing the necessary impetus to complete debt restructuring. Two major incentives were introduced recently to accelerate corporate restructuring. The first is to exempt all instruments involved in corporate debt restructuring from stamp duty, a saving of up to 4% of the transaction amount for distressed companies and their creditors. The second is to allow all non-revenue expenses incurred in debt restructuring scheme to be allowed as a deduction for the purpose of income tax computation. These incentives are for a limited period only and will cease to apply after December 2000. Therefore, Malaysian companies seeking to take advantage of these tax benefits will have to come to a debt restructuring arrangement by June 2000 to ensure their restructuring scheme can be completed before end-December 2000.

Thank you.